YOUNG, SHERON

From: _Regulatory Comments
Sent: Tuesday, April 25, 2006 9:27 AM
To: YOUNG, SHERON
Subject: FW: David M. Low Comments on Part 715 ANPR, Supervisory Committee Audits

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From: L & D [mailto:becerrilow@comcast.net]
Sent: Tuesday, April 25, 2006 2:33 AM
To: _Regulatory Comments
Subject: David M. Low Comments on Part 715 ANPR, Supervisory Committee Audits

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Ms. Rupp:

I have chosen at this late hour to address the central issue contained in the Board's Advanced Notice of Proposed Rulemaking on Supervisory Committee Audits (ANPR). Therefore, I am confining my response to just the first question of the 22 covered in the ANPR.

To preface, I think it appropriate to remark on the lack of balance in the request as it relates to audit attestation on internal controls. Although the Summary of the ANPR requests public comment on whether and how to modify the Supervisory Committee audit rules to require credit unions to obtain an 'attestation on internal controls, only the first question out of seven concerning this issue addresses the 'whether' portion. Subsequent questions assume the answer is positive for the attestation requirement, and they go on to solicit input on application and technical aspects. In fact, the ANPR states NCUA already concurs with the General Accounting Office, now General Accountability Office, (GAO) opinion; so, one wonders if the solicitation of public input as to whether attestation audits should be mandated is a formality with little chance of reversal.

I would hope that is not the case, and time remains to conduct an analysis of the real value of internal control attestation audits for credit unions and consider alternatives. This analysis along with other options should be made available prior to a proposed rule change requiring attestation audits.

NCUA should consider the broader implications of mandating an attestation on internal controls audit where the rationale is based on precedence set by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FIDICIA) and the Sarbanes-Oxley Act of 2002 (SOX). The impetus behind these two laws came from high profile failures in the thrift/banking industries (FDICIA) and the corporate world (SOX). Common background elements for both situations were greed, arrogance, unhealthy ambition; along with disregard, circumvention, and exploitation of existing laws and regulations. Although, the credit union world is certainly not exempt from any of these elements, an innate control mechanism is hardwired into the credit union business model that was and is not present with stock owned banks and public companies.

This intrinsic control is the credit union structure that relies on ownership by members through the one-share-one vote principle as opposed to stock ownership. Credit union shareholders are not motivated the same way stockholders are, since the value of a share is always par. The incentive for financial statement fraud of the magnitude seen with stock based companies (banks or public companies) is less because the personal profit motive through manipulation of financial statements and operating results is less.

Now, it would be wrong to say credit union management does not commit fraud or has no incentive to do so. As a former (13 years) NCUA examiner and Problem Case Officer, I dealt first hand with management fraud motivated by various reasons. I have examined credit unions and know about cases where financial results were misstated. In my experience, fraud is like any other risk in the sense it exists, it needs to be managed, and there is a point where the costs of containing the risk outweigh the benefit.

It is this last point, cost/benefit, that NCUA should focus. The cost of compliance is staggering based on opinions from CPAs and others. Upwards of $300,000 just for the attestation audit is mind boggling. To my knowledge, NCUA has not published a study or provided any data informing credit unions what the cost of compliance would be. This would surely need to be done before a regulation requiring internal control attestation audits is proposed.

With respect to attestation audits, NCUA needs to conduct an unbiased assessment of their value before issuing a proposed rule requiring attestation audits for credit unions, regardless of asset size. At a minimum, the assessment should:

- Analyze all credit union failures where financial statement fraud was the primary reason for failure to determine if an attestation on internal controls would have identified, mitigated or prevented the failure.
- Review the FDIC's experience since FDICIA was enacted. It would seem that in the 15 years since passage, the FDIC will have had time to determine the value of internal control attestation to the Bank Insurance Fund and Savings Association Insurance Funds as well as the FDIC's stakeholders.
- Consider the inherent structural difference (member shares versus stock ownership model) as a contributing factor in creating incentives for financial statement fraud.
- Determine the real – not perceived - value of an internal control attestation audit to the NCUSIF, credit union members, and potential members.
- Estimate the costs that the average credit union subject to an attestation audit on internal controls would have to incur in order to comply with such a mandate. Include both the expense necessary for credit union management to provide an assessment and the cost of the attestation by an independent external CPA.
- Evaluate alternatives to an internal control attestation audit. After all, in its report, the GAO said " Extension of the internal control reporting requirement to credit unions with assets over $500 million could provide NCUA with an additional tool to assess the reliability of internal controls over financial reporting." [Page 52, GAO-04-91 Changes in Credit Union Industry] For example, an 'additional tool' that might be effective and acceptable to the GAO would be an internal audit program that conforms to the high standards promulgated by The Institute of Internal Auditors.
- Weigh the cost of an internal controls attestation audit against the real value and alternatives. Present the findings to the public and to the GAO to demonstrate and support why NCUA ultimately takes the position it does.

At this point, until such a study is conducted and results published, I think it premature to respond to the implementation questions concerning the attestation question.

Thank you for the opportunity to respond to the ANPR.

Sincerely,

David M. Low